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RUEHWL/AMEMBASSY WELLINGTON PRIORITY 5460
RUEHLO/AMEMBASSY LONDON PRIORITY 1872
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SUBJECT: AUSTRALIAN CENTRAL BANK SLASHES OFFICIAL BANK RATE

11. (U) Summary: Australia slashed its official cash rate by 100 basis points on Tuesday, based on fears that the economy will slow down and on concerns about international financial markets. Initial reactions have been positive, with Australia share prices rising on Tuesday. End summary.

12. (U) The Reserve Bank of Australia (RBA) today (October 7) slashed its official cash rate by 100 basis points, double the 50 basis point reduction that had been widely predicted by market analysts. RBA Governor Glenn Stevens, in his official statement, said that recent deterioration in prospects for global growth and the difficulty for even creditworthy borrowers to access credit means demand and output may fall quicker than expected, likely reducing inflation (expected to be 5% for the quarter which ended September 30) earlier than anticipated. Stevens' statement also cited weakening economic activity in major countries and the "significant turn for the worse" for international financial markets in September. The RBA's cash rate now stands at 6%.

13. (U) The RBA decision - the first 1% cut since 1992 - comes at a time when Australian markets are showing weakness, and initial reactions were positive. Share prices on the Australian Stock Exchange (ASX) plunged 8% at one point on Monday before recovering to end down by "only" 3.6%. The ASX, which had been down 3% in Tuesday morning trading, quickly moved into positive territory following the mid-afternoon announcement, with banks doing particularly well. The Australian dollar hit four-year lows overnight, dropping below US\$.70 before recovering slightly this morning; however, the Aussie dollar may drop further with the RBA's decision. The Australian dollar hit a 25-year high of US\$.985 in July but has dropped sharply since, losing over 10% of its value in the last week alone.

14. (SBU) Comment: One analyst at a major bank told econoff that this clearly demonstrates that the RBA no longer believes this is a normal business cycle - and believed further cuts may be in the offing, particularly if Australia's economy begins to slow down at a quicker pace. With the possibility of falling global commodity prices, which have to date underpinned the growth in the Australian economy, business confidence needed a sharp boost, which the RBA has provided. In the run-up to this decision, Opposition Leader Malcolm Turnbull had been criticizing Treasurer Wayne Swan for not insisting that banks pass on the full expected 50-basis point to mortgage holders. The 100 basis point cut will give banks room to pass on big cuts to mortgage holders and still reduce their borrowing costs significantly.

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